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December 11, 2002

VIA ELECTRONIC FILING

Marlene Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W. – Room TWB-204
Washington, D.C. 20554

Re: Notice of *Ex Parte*
In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate
And Related Requirements, WC Docket No. 02-112

Dear Ms. Dortch:

On Tuesday, December 10, 2002, Robert Quinn, Jr. and the undersigned of AT&T Corp., and David Lawson, outside counsel for AT&T Corp., met with Jordan Goldstein of Commissioner Michael Copps' office to discuss the issues in the above captioned-proceeding relating to the sunset of the requirements of section 272. The views expressed during the meeting were consistent with AT&T's comments and reply comments filed in the proceeding. AT&T also used a handout at the meeting, which is attached to this letter.

Section 272 was expressly designed by Congress to limit the BOCs' demonstrated ability to use their enduring market power to harm their interLATA rivals from the date of BOC entry into the interLATA market – at which time local markets have been determined merely to be *open* to potential competition – until the local markets actually *become* competitive and market forces provide an effective substitute for the state and federal oversight enabled by the accounting, audit and other section 272 safeguards subject to the sunset provision. As the Commission has repeatedly recognized, and as the state commissions have uniformly stressed in their comments, the section 272 accounting, audit and separation requirements are essential tools for the detection and deterrence of discrimination and cost misallocation in the critical period after section 271 authorization but before the BOC's local market power dissipates. In particular, these tools provide the transparency needed to measure compliance with nondiscrimination and other conduct requirements. And there is overwhelming and essentially undisputed evidence in the record of this proceeding that the BOCs – even years after they receive authorization under section 271 to offer in-region, interLATA services – continue to dominate and maintain market power in local

markets. In particular, the state commissions in New York and Texas have found that the BOCs in those states retain dominance over critical local services used in providing interLATA services – and have determined that it is premature to allow the requirements of section 272 to sunset.

It is likewise clear that there is absolutely no merit to the BOCs' theory that the requirements of section 272 sunset on a "region-wide" basis (*e.g.*, that the requirements for every Verizon BOC would sunset immediately once they are allowed to sunset for Verizon-New York). This frivolous interpretation of the Act would render section 272's requirements moot for many states where section 271 authorizations have yet to be obtained (or even sought). And as explained fully in AT&T's reply comments, the text, structure and purposes of the Act all make clear that any sunset necessarily must apply only on a state-by-state basis (*i.e.*, in 2005 for Verizon-Virginia, which the Commission authorized to provide in-region interLATA services earlier this year).

The most pressing issue is therefore the application of the section 272 safeguards in New York, where the requirements of section 272 would sunset on January 4, 2003 unless the Commission declares otherwise by rule or order.[1] AT&T submits that there is no reasoned basis on the record in this proceeding – including the New York PSC's finding that Verizon retains overwhelming market power in the provision of special access services even in Manhattan, the area with the most competition – to allow the section 272 safeguards to sunset in New York. Indeed, the record provides ample support for a final Commission decision that the safeguards should continue to apply in New York for an additional three years (or at least until another biennial audit is completed). At a minimum, however, the Commission should issue an order temporarily extending the operation of the section 272 safeguards in New York to allow the Commission thoroughly to review the evidence that the section 272 safeguards remain necessary in New York for some period beyond 3 years.[2] Given the essentially undisputed evidence that Verizon maintains market power in New York, the findings of the NYPSC that Verizon remains dominant throughout New York State in the provision of access services, and the NYPSC's view that it would be premature to sunset the section 272 requirements because Verizon has not informed the NYPSC that it intends to abandon its separate affiliate structure, such an interim order would plainly be supported by the record in this proceeding.

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[1] The Commission order acting on Verizon's section 271 application for New York was adopted on December 22, 1999, but the Commission did not make that order effective until January 3, 2000. *See Application by Bell Atlantic New York*, 15 FCC Rcd. 3953, ¶ 458 (1999). Accordingly, Verizon was not "authorized" to provide in-region interLATA services in New York until January 3, 2000, and section 272(f)(1) makes clear that the section 272 requirements will sunset no earlier than "3 years after the date" the BOC is "authorized" pursuant to section 271. 47 U.S.C. § 272(f)(1).

[2] Given the significant and pro-competitive purposes of section 272 and the record evidence in this case showing that Verizon maintains market power in New York, the Commission would plainly be justified in entering an interim order extending the section 272 requirements in New York, while it continues to consider the proper timing for the more generally applicable sunset of section 272 requirements. *See, e.g.*, *MCI Telecomm. Corp.* v. *FCC*, 750 F.2d 135, 140 (D.C. Cir. 1984) ("substantial deference by courts is accorded to an agency when the issue concerns interim relief"); *Wellford* v. *Ruckelshaus*, 439 F.2d 598, 601 (D.C. Cir. 1971) (same); *cf. CompTel* v. *FCC*, 87 F.3d 522, 531 (D.C. Cir. 1996) ("The proper judicial response to an interim rule is . . . to review it with the understanding that the agency may reasonably limit its commitment of resources to refining a rule with a short life expectancy"). Moreover, the text of section 272(f)(1) is clear that the Commission may act either by "rule or order," which makes clear that the Commission is authorized to extend the section 272 requirements for particular BOCs.

The one course that plainly would be both arbitrary and irresponsible is for the Commission to do nothing and allow the section 272 protections to sunset in New York without even addressing the arguments and evidence submitted by state commissions and others. The Commission has previously recognized that the only appropriate response to competing arguments that one of the Act's separate affiliate requirements should or should not sunset is to issue an order that decides the issue one way or the other and explains the basis for that decision. Thus, in 2000, when the section 272 safeguards regarding the BOCs' provision of interLATA information services were due to expire, the Commission issued a public notice in response to a petition filed by an interested party, solicited public comment, and, after consideration of those comments, issued an order determining that those section 272 safeguards should expire.[3] Likewise, in this case, the Commission – having issued a notice setting forth its tentative positions and soliciting comments on the sunset of other section 272 safeguards – should issue an order that resolves the sunset issues (at least on the interim basis described above) and that fully explains the reasoning for its determination.

Indeed, given the full record that has been developed in this proceeding and the importance of the issue, it would violate basic precepts of administrative law for the Commission to do nothing and allow the section 272 protections to expire in New York without addressing the arguments that the accounting, audit, and structural safeguards in section 272 are still vital to detecting and preventing the anticompetitive conduct that, by virtue of Verizon's ongoing market power in New York, is certain to harm the heretofore robustly competitive interLATA markets in that State. Thus, it is well-established that an agency acts arbitrarily and unlawfully if it does not "give reasoned responses to all significant comments."[4] And even where an agency has discretion in determining to issue or extend a rule, "an agency's failure to cogently explain why it has exercised its discretion in a given manner renders its decision arbitrary and capricious."[5] In particular, the D.C. Circuit has determined that where an agency issues a public notice requesting comment on an issue, but then later terminates the docket and decides not to act at all, the agency remains "oblige[d] . . . to consider the comments it received, and to articulate a reasoned explanation" and a "satisfactory explanation for its termination of [the] docket."[6] In the circumstances of this proceeding, these administrative law principles preclude the Commission from simply allowing the section 272 safeguards to sunset without issuing an order addressing the record in this proceeding.

For the reasons stated above, the Commission should promulgate a rule extending the section 272 safeguards for all BOCs for at least another three years, or, at

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[3] *See Request For Extension of the Sunset Date of the Structural, Nondiscrimination, and Other Behavioral Safeguards Governing BOC Provision of In-Region, InterLATA Information Services*, 15 FCC Rcd. 3267 (2000).

[4] *International Fabricare Inst.* v. *EPA*, 972 F.2d 384, 389 (D.C. Cir. 1992); *see Motor Vehicles Manu. Ass'n* v. *State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *Appalachian Power Co.* v. *EPA*, 249 F.3d 1032, 1059 (D.C. Cir. 2001) (it is arbitrary and capricious where an agency fails "to respond to specific challenges that are sufficiently central to its decision").

[5] *International Ladies' Garment Workers Union* v. *Donovan*, 722 F.2d 795, 815 (D.C. Cir. 1983).

[6] *See Williams Natural Gas Co.* v. *FERC*, 872 F.2d 438, 450 (D.C. Cir. 1989); *see id.* ("the agency, having expressed [] tentative views and having solicited comments on the issue, was not free to terminate the rulemaking for no reason whatsoever").

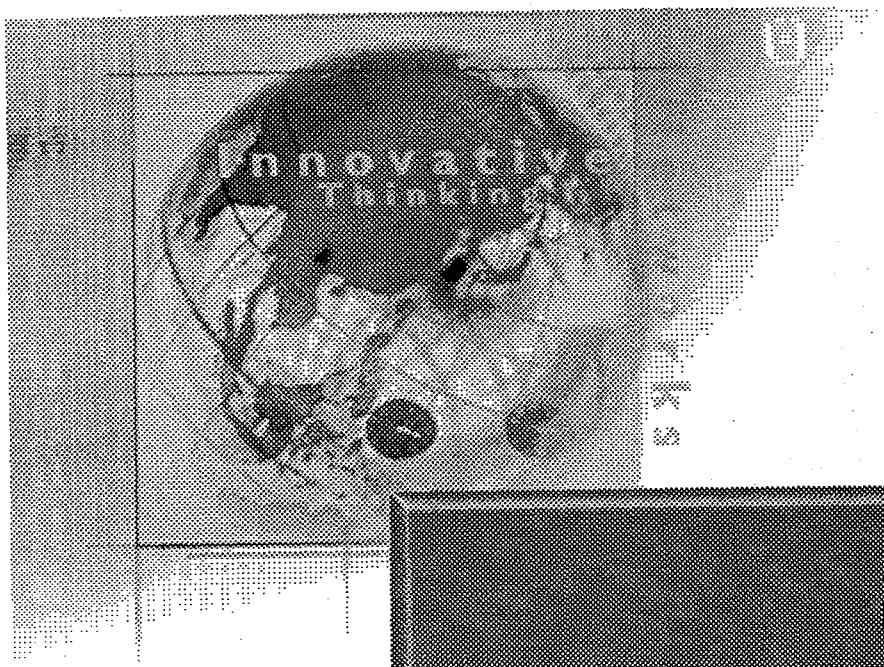
a minimum, issue an interim order extending those safeguards in New York pending the Commission's promulgation of a final rule applicable to all BOCs.

One electronic copy of this Notice is being submitted to the Secretary of the FCC in accordance with Section 1.1206 of the Commission's rules.

Sincerely,

Enclosures

cc: J. Goldstein



Section 272 Structural And Accounting Safeguards

AT&T Presentation

November 26, 2002

AT&T

Summary

- BOCs Asking for Removal of Accounting, Affiliate Transaction Safeguards When Other Agencies Strengthening Such Protections
- BOCs Retain Market Power, Dominance Even Years After 271 Authorization (NY, Tex.)
- BOCs Have Incentives And Demonstrated Ability To Discriminate and Misallocate Costs
- § 272 Is A Unique Enforcement Tool That Provides Transparency (PUCs Want To Retain)

BOCs Have Greater Incentives And Ability To Harm InterLATA Market

- "Fundamental Postulate" Of Telecommunications Law Is That LECs Have "Both The Incentive And Ability To Discriminate Against Competitors"
- BOCs Have Long History Of Discrimination, Accounting Gimmicks To Favor Affiliates
- Once LD Authorization Provided, BOCs' Incentives To Prefer Its LD Affiliate And Harm New InterLATA Rivals Become Much Stronger

§ 272 Is A Critical Pro-Competitive Tool

- § 272 of "Crucial Importance" To Preserve A "Level Playing Field" in InterLATA Market
- Congress Designed Section 272 To Apply After 271 Entry, Until BOC Dominance Of Local Markets Ceases
- Intended To Detect And Help To Prohibit BOCs' Ability To Discriminate, Raise Rivals' Costs

BOCs Dominate Local Markets

- Even In New York, 3 Years After LD Entry, Verizon Has Market Power In Local Services
- Particularly In Special Access, Key LD Input NYPSC: Verizon "Continues To Dominate"
- SBC Controls Local Market In Texas; Other States (Okla./Kan.) Lag Even Farther Behind
- Overwhelming Evidence That It Takes More Than 3 Years For Full Competition To Develop
- BOCs Able To Discriminate, Cross-Subsidize

§ 272: Practical Enforcement Tool

- As State PUCs Confirm, § 272 Provides Transparency Of Accounting, Affiliate Transactions, Performance Measures
- No Way To Discover BOC Violations Absent Structural, Accounting Safeguards
  - *E.g.*, Identifying Cost/Revenue Data "Critical" To Rate Review (Pa. PUC)
  - *SBC/Ameritech Merger Order* ¶¶ 206, 211, 220, 260 (Use of Separate Affiliate For Advanced Services "will mitigate substantial risk of discrimination")
- Other Tools Not As Effective
  - Audits Have Yet To Be Conducted Properly (Despite Inadequacies, Material Violations Still Uncovered)
  - LEC Mergers Have Reduced Benchmarking, Hindering Regulators

Costs Of Compliance Small

- BOCs' Claims Of High Compliance Costs Have Never Been Substantiated
  - Verizon Data On OI&M Costs Withheld
- Structural Separation Used In Mergers As Cost-Effective Method To Police Misconduct
- Safeguards Ease Enforcement Actions
- Less Costly Than Other Remedies
- Has Not Hindered BOC Entry in LD

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Ample Evidence Of BOC Misconduct

- Special Access Performance Is Discriminatory And Rates Are Excessive
  - NYPSC Report: "below . . . acceptable quality" and Verizon "treats other carriers less favorably" Audit found similar problems
  - AT&T has shown that BOC on-time performance *decreasing* over time
- Ability To Manipulate PIC Process
- Cost Misallocation: Evidence of Price Squeezes, Unlawful Affiliate Transfers
  - California Audit: Joint Marketing "clearly demonstrates cross-subsidization;" Affiliate obtain free access to BOC databases

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Conclusions

- Extend § 272 Requirements For At Least An Additional 3 Years
- Retain OI&M Rules
  - sharing of these "core functions" would create "substantial opportunities" for cost misallocation and "inevitably" result in discriminatory treatment (Non-Accounting Safeguards Order)
- BOC "Regional" Sunset Theory Has No Statutory Basis
- Improve Audits, 272 Enforcement